RECONSIDERATION EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED BY THE ENSIGN GROUP, INC PROPOSING TO ADD 30 SKILLED NURSING BEDS TO PARK MANOR REHABILITATION CENTER IN WALLA WALLA COUNTY

PROJECT DESCRIPTION

The Ensign Group, Inc is a Delaware corporation that does not directly own, operate, or manage any healthcare facilities, however, it owns the membership interests or stock of a number of subsidiaries that do own, operate, or manage facilities. The Ensign Group was founded in 1999 and is ultimately responsible for the operations of 43 skilled nursing facilities in the states of California (27), Arizona (11), Texas (4), and Washington (1). The Ensign Group is the sole member of the Manor Park Healthcare limited liability corporation (LLC). This application was submitted by The Ensign Group, Inc., who is considered the applicant. [source: Application p2, and The Ensign Group, Inc. website at www.ensigngroup.net and a related website known as www.ensignwatch.com]

Manor Park Healthcare, LLC is a Nevada limited liability corporation that is registered in Washington State. Manor Park Healthcare is currently the licensee and operator of Park Manor Rehabilitation Center in the city of Walla Walla. [source: Application, p2]

Park Manor Rehabilitation Center is a 79-bed skilled nursing facility (SNF) located at 1710 Plaza Way in the city of Walla Walla, within Walla Walla County. This project proposes to add 30 beds to Park Manor Rehabilitation Center, for a facility total of 109. [source: Application p2, and CN historical files] The addition of the 30 beds would be accomplished by adding another 12,740 square feet to the existing 33,290 square foot building. The additional space would include 10 private rooms, 10 semi private rooms, administrative offices and support areas, physical/occupational/speech therapy space, and common space. [source: Application, p9 and Exhibit E]

The anticipated date of commencement of construction of the facility is September 2005, with an estimated completion date of September 2006. The facility is expected to begin serving patients within the new space in October 2006. Therefore, the first full year of operation is projected to be calendar year 2007. [source: Application, p11, and December 29, 2004, supplemental information, p4] If this project is approved under reconsideration, the applicant could meet its estimated timeline. Therefore, the department recognizes year 2007 would be the facility's first full year of operation with 109 beds.

The estimated capital expenditure for this project is $1,792,656, of which 75% is related to construction costs; 16% is related to permits and fees; 6% is related to state sales tax; and the remaining 3% is related to equipment (both fixed and moveable). [source: Application, p20]

BACKGROUND INFORMATION ON THE PROJECT

On September 30, 2004, The Ensign Group, Inc. and Laurel Hill Enterprises, Inc.--two separate entities--submitted two separate applications proposing nursing home bed additions at separate nursing homes located in Walla Walla County. As required under the nursing home current review schedule outlined in Washington Administrative Code (WAC) 246-310-130, the two projects were reviewed concurrently. On December 9, 2005, the department approved the Laurel Hill Enterprises, Inc. application and denied The Ensign Group, Inc.'s ("EGI") application.[1]

EGI's denial is based on its failure to meet the criteria related to financial feasibility and cost containment. On January 5, 2005, EGI submitted its "Request for Reconsideration" related to the department's denial, which included information related to the criteria denied.[2] On February 13, 2006, the department conducted a public hearing and received additional clarifying information from EGI, as well as comments from any affected or interested persons. On March 1, 2006, the department allowed EGI to submit rebuttal comments related to any comments received at the public hearing, and then proceeded with this evaluation of the reconsideration information.

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to Certificate of Need review as the establishment of a new health care facility under the provisions of Revised Code of Washington (RCW) 70.38.105(4)(a) and Washington Administrative Code (WAC) 246-310-020(1)(a).

APPLICATION CHRONOLOGY

Initial Review

August 16, 2004	Letter of Intent Submitted
September 30, 2004	Application Submitted
October 1, 2004 through January 17, 2005	Department's Pre-Review Activities • 1st screening activities and responses • 2nd screening activities and responses
January 18, 2005	Department Begins Review of the Application • public comments accepted throughout review
March 18, 2005	End of Public Comment/No Public Hearing Conducted
April 18, 2005	Rebuttal Documents Received at Department
June 17, 2005	Department's Anticipated Decision Date
December 9, 2005	Department's Actual Decision Date

Reconsideration Review

January 5, 2006	Applicant Submits Request for Reconsideration, including supplemental documentation
January 18, 2006	Department Grants Reconsideration and Requests Supplemental Information from Applicant
February 13, 2006	Reconsideration Public Hearing Conducted in Walla Walla Information Submitted by Applicant & Interested Person
March 1, 2006	Rebuttal Documents Received at Department
April 17, 2006	Department's Anticipated Reconsideration Decision Date
April 10, 2006	Department's Actual Reconsideration Decision Date

[1] On December 20, 2005, CN #1322 was issued for the Laurel Hill Enterprises, Inc. project.
[2] WAC 246-310-560.

AFFECTED OR INTERESTED PERSON STATUS

As previously stated, the initial review of this project was conducted under the nursing home concurrent review cycle outlined in WAC 246-310-130(5)(c). For each application, the only entity that sought and received affected person status under WAC 246-310-010 was each applicant. As a result, the department recognized:

- Laurel Hills Enterprise, Inc. is an affected person for the application submitted on behalf of The Ensign Group, Inc; and
- The Ensign Group Inc. is an affected person for the application submitted on behalf of Laurel Hills Enterprise, Inc.

During the reconsideration review of the EGI application, Laurel Hill Enterprise, Inc. did not pursue affected person status, attend the public hearing, or submit comments regarding this reconsideration review. One entity, Department of Social and Health Services (DSHS), sought and received interested person status during the EGI reconsideration process. Under interested person status, DSHS attended the public hearing and provided written comments regarding the reconsideration documents submitted by EGI.

SOURCE INFORMATION REVIEWED FOR RECONSIDERATION PROCESS ONLY

- The Ensign Group, Inc.'s Certificate of Need Application related to Park Manor Rehabilitation Center received September 30, 2004
- The Ensign Group, Inc.'s supplemental information dated December 29, 2004, and January 26, 2005
- The Ensign Group, Inc.'s reconsideration information dated January 4, 2006
- The Ensign Group, Inc.'s supplemental information dated February 8, 2006
- Department of Social and Health Services information submitted at the February 13, 2006, reconsideration public hearing dated February 10, 2006
- The Ensign Group, Inc.'s rebuttal comments dated February 28, 2006

CRITERIA EVALUATION

To obtain Certificate of Need approval, The Ensign Group, Inc. must demonstrate compliance with the criteria found in WAC 246-310-210 (need); 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); 246-310-240 (cost containment) and WAC 246-310-360 (nursing home bed need method).[3]

In its December 9, 2005, initial evaluation, the department concluded that EGI's project met the criteria under WAC 246-310-210 (need); 246-310-230 (structure and process of care); and 246-310-360 (nursing home bed need method). However, the department concluded that the project failed to meet the criteria under WAC 246-310-220 (financial feasibility); and 246-310-240 (cost containment). This reconsideration evaluation will focus on information related to the criteria

[3] Each criterion contains certain sub-criteria. The following sub-criteria are not relevant to this project: WAC 246-310-210(3), (4), (5), and (6).

previously denied--WAC 246-310-220 (financial feasibility); and WAC 246-310-240 (cost containment).[4]

CONCLUSION

For the reasons stated in this evaluation, the application submitted on behalf of The Ensign Group, Inc. proposing to add 30 nursing beds to the existing 79 beds at Park Manor Rehabilitation Center, for a total of 109 beds, is consistent with applicable criteria of the Certificate of Need Program, and a Certificate of Need should be issued.

[4] Under program rules, a project must demonstrate compliance with all relevant sub-criteria found in each criterion.

A. Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed, the department determines that the application is consistent with the applicable financial feasibility criteria in WAC 246-310-220.

(1) *The immediate and long-range capital and operating costs of the project can be met.*

Initial Evaluation Summary

Within its initial evaluation, the department concluded that the Park Manor project did not meet this sub criterion because EGI calculated its projected balance sheet and statement of operations based on a higher Medicaid reimbursement rate than the rate calculated by DSHS Office of Rates Management (ORM) staff.[5] When the department re-calculated Park Manor's projected statement of operations using the Medicaid reimbursement rate provided by ORM, Park Manor would be operating at a loss of $129,955 in year 2007, which decreased to a loss of $58,955 by the end of year 2009.

Further, the department recognized that the financial loss identified for years 2007 through 2009 were based on the facility's ability to reach its projected 95% occupancy of the 109 beds in each of the three years of operation as projected by EGI. The department concluded that if Park Manor was unable to meet its projected occupancy levels, then the loss could be greater.

Reconsideration Evaluation

ORM sets Medicaid rates for long term care nursing facilities individually for each specific facility. Rates are based generally on a facility's costs, its occupancy level, and the individual care needs of its residents. The Medicaid payment rate system does not guarantee that all allowable costs relating to the care of Medicaid residents will be fully reimbursed. The primary goal of the system is to pay for nursing care rendered to Medicaid-eligible residents in accordance with federal and state laws, not to reimburse costs--however defined--of providers. A facility's overall Medicaid rate is comprised of rates for the following seven separate components:

- Direct care - nursing care and related care provided to residents
- Therapy care - speech, physical, occupational, and other therapy
- Support services - food and dietary services, housekeeping, and laundry
- Operations - administration, utilities, accounting, and maintenance
- Variable return - an incentive payment for relative efficiency
- Property - depreciation allowance for real property improvements, equipment and personal property used for resident care
- Financing allowance - return on the facility's net invested funds i.e., the value of its tangible fixed assets and allowable cost of land

[source: An Overview of Medicaid Rate Setting for Nursing Facilities in Washington provided by DSHS]

For existing nursing homes, the component rates are based on examined and adjusted costs from each facility's cost report. Direct care, therapy care, support services, operations and

[5] In Washington State, Medicaid nursing facility rates are set by the Nursing Home Rates Section of the Office of Rates Management part of the Aging and Disability Services Administration of the Department of Social and Health Services.

variable return component rates for July 1, 2001, through June 30, 2004, are based on 1999 cost reports. Property and financing allowance components are rebased annually. [source: An Overview of Medicaid Rate Setting for Nursing Facilities in Washington provided by DSHS]

All component rates require, directly or indirectly, use of the number of resident days--the total of the days in residence at the facility for all eligible residents--for the applicable report period. Resident days are subject to minimum occupancy levels. Effective July 1, 2002, the minimum occupancy for direct care, therapy care, support services, and variable return component rates is 85%; for operations, financing allowance, and property component rates, the minimum occupancy rate is 90%.[6] If resident days are below the minimum, they are increased to the imputed occupancy level, which has the effect of reducing per resident day costs and the component rates based on such costs. If the actual occupancy level is higher than the minimum, the actual number of resident days is used. [source: An Overview of Medicaid Rate Setting for Nursing Facilities in Washington provided by DSHS]

For this reconsideration process, ORM provided a recalculation of the Medicaid rate with the following explanation. [source: February 10, 2006, DSHS, ORM public hearing documents]

> *"We originally sent our analysis of the Park Manor Certificate of Need application to the Department of Health on January 13, 2005. At the time, we used the most recent Medicaid rate (January 1, 2005) to calculate the estimated Medicaid rate at project completion. Our calculation was for an estimate rate of $107.25, which we still believe was correct at the time. Due to the reconsideration request, we have recalculated the rate using the current most recent Medicaid rate (January 1, 2006). The new estimated rate is $111.68, which is still $12.88 lower than the $124.56 Medicaid rate suggested by Park Manor in its application.* [ORM attached the revised calculations with its February 10, 2006, letter] *The new estimated Medicaid rate reflects increases in the property and financing allowance section for a facility renovation that was competed in December of 2004. Asset additions for 2004 are not included in a facility's Medicaid rate until July 1, 2005, which is why the additions were not reflected in our first estimated Medicaid rate. In addition, the Medicaid rate increased due to a higher facility case mix score which raises the direct care component. The case mix score is revised quarterly and may increase or decrease according to the debility scores of the individual residents."*

Within its reconsideration documents, EGI recalculated its projected statement of operations and balance sheets based on the revised Medicaid rate provided by ORM above. Further EGI asserts that reduced revenue resulting from a reduced Medicaid rate would also affect three specific expenses identified within the projected financial documents--management fees, income taxes, and state excise taxes. EGI states that these three line items identified in the statement of operations are revenue driven and would decrease with a decrease in revenue. Below is a summary of EGI's rationale for reducing the three expense line items. [source: February 8, 2006, reconsideration documents, pp1-3]

[6] For essential community providers--i.e., facilities at least a forty minute drive from the next closest nursing facility--the minimum occupancy is set at 85% for all components in recognition of their location in lesser-served areas of the state. Park Manor Rehabilitation Center does not meet the definition of an essential community provider.

Management Fees

While Park Manor Rehabilitation Center is not operated under a management agreement, it obtains management-type services from its parent organization, EGI. Services provided by EGI to Park Manor Rehabilitation Center include: accounting, financial analysis, payroll services, accounts payable processing, billing and collections, financing, clinical systems and support, legal assistance and compliance support, tech support, training and continuing education for staff, human resources oversight, risk management services, centralized contracting and vendor management, and tax filings and other tax related services. In return for these services, Park Manor Rehabilitation is assessed a fee of 5% of its net revenue. The costs associated with these services are shown in the facility's statement of operations as "management fees."

Income Taxes

This line item within the statement of operations is based on a 34% rate applied to net income before income taxes. With the reduction in Medicaid reimbursement at Park Manor Rehabilitation Center, this line item would also be reduced accordingly.

Washington State Excise Tax

Washington State excise taxes are based on 1.5% of the facility's net revenue. As with the income taxes above, with the reduction in Medicaid reimbursement at Park Manor Rehabilitation Center, this line item would also be reduced.

The anticipated date of commencement of construction of the facility is September 2005, with an estimated date of completion of September 2006. The facility is expected to begin serving patients within the new space in October 2006. Therefore, the first full year of operation is projected to be calendar year 2007. [source: Application, p11, and December 29, 2004, supplemental information, p4]

To assist in the department's determination of whether Park Manor Rehabilitation Center would meet its immediate and long range operating costs with an additional 30 SNF beds under this reconsideration, EGI provided revised pro forma financial documents reflecting the reduction in Medicaid reimbursement calculated by ORM. The revised financial documents also include the appropriate reductions in the three revenue-driven expenses described above. A summary of the balance sheets is shown in Reconsideration Tables I below. [source: February 28, 2006, reconsideration rebuttal documents, Attachment 1]

Reconsideration Tables I
Park Manor Rehabilitation Center Balance Sheet for Projected Years 2007-2009
Year 2007

Assets		**Liabilities**	
Total Current Assets	$ 2,387,000	Total Current Liabilities	$ 339,000
Fixed Assets	$ 206,000	Other Liabilities	$ 0
Other Assets	$ 2,000	**Total Liabilities**	**$ 339,000**
		Equity	$ 2,256,000
Total Assets	**$ 2,595,000**	**Total Liabilities and Equity**	**$ 2,595,000**

Year 2008

Assets		Liabilities	
Current Assets	$ 2,474,000	Current Liabilities	$ 340,000
Fixed Assets	$ 206,000	Other Liabilities	$ 0
Other Assets	$ 2,000	**Total Liabilities**	**$ 340,000**
		Equity	$ 2,342,000
Total Assets	**$ 2,682,000**	**Total Liabilities and Equity**	**$ 2,682,000**

Year 2009

Assets		Liabilities	
Current Assets	$ 2,610,000	Current Liabilities	$ 341,000
Fixed Assets	$ 206,000	Other Liabilities	$ 0
Other Assets	$ 2,000	**Total Liabilities**	**$ 341,000**
		Equity	$ 2,477,000
Total Assets	**$ 2,818,000**	**Total Liabilities and Equity**	**$ 2,818,000**

In addition to the revised projected balance sheets provided above, the applicant also provided its revised Statement of Operations for years 2007 through 2009 as a 109 bed facility. [source: February 28, 2006, reconsideration rebuttal documents, Attachment 1] A summary of the Statement of Operations is shown in Reconsideration Table II below.

Reconsideration Table II
Park Manor Rehabilitation Center Statement of Operations Summary
Projected Years 2007 through 2009

	Year One (2007)	**Year Two (2008)**	**Year Three (2009)**
# of Beds	109	109	109
# of Patient Days	37,797	37,998	38,209
% Occupancy	95%	96%	96%
Net Revenue*	$ 5,799,000	$ 5,877,000	$ 5,958,000
Total Expense	$ 5,669,000	$ 5,725,000	$ 5,771,000
Net Profit or (Loss)	$ 130,000	$ 152,000	$ 187,000
Net Revenue per patient day	$ 153.42	$ 154.67	$ 155.93
Total Expenses per patient day	$ 149.99	$ 150.67	$ 151.04
Net Profit or (Loss) per patient day	$ 3.44	$ 4.00	$ 4.89

*Includes deductions for bad debt and contractual allowances

As shown in Reconsideration Table II above, with the reduced Medicaid reimbursement and revenue-driven expenses, Park Manor Rehabilitation Center would be operating at net profit of $130,000 in year 2007, which increases to a slightly larger profit of $187,000 by the end of year 2009. This profit is based on the facility's ability to reach its projected 95% occupancy of the 109 beds in each of the three years of operation as projected by the applicant.

Based on the financial information above, the department concludes that the long-term capital and operating costs of this project would be met with an additional 30 beds at Park Manor Rehabilitation. Further, the department concludes that the long term financial viability of the facility would not be negatively affected operating as a 109 bed facility. This sub-criterion is met.

(2) *<u>The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.</u>*
To assist the department in its evaluation of this sub-criterion, ORM provides summary of the reasonableness of building construction costs, which includes a building lid calculation. The building lid calculation is determined by:

1) locating the class of construction (A, B, C, D) and quality of construction (good, average, low) and multiplying by the number of beds proposed by the appropriate per bed base cost; and
2) identifying the appropriate base cost for the facility (using the same class and quality of construction).

These figures are added to determine the construction cost lids. Final lid values will be adjusted for inflation using the actual charge in the appropriate cost indexes. Additionally, *"the building lid only affects the property and finance allowance components of the Medicaid rate."*[7] [source: Office of Rates Management evaluations]

<u>Initial Evaluation Summary</u>
Within its initial evaluation, the department concluded that EGI's application was consistent with this sub-criterion.

<u>Reconsideration Evaluation</u>
Given that the data used by ORM to calculate the construction cost lid did not change under this reconsideration, ORM did not provide revised building cost lid calculations. Therefore, there was no additional information provided during the reconsideration review that would change this conclusion by the department. This sub-criterion remains met.

(3) *<u>The project can be appropriately financed.</u>*
<u>Initial Evaluation Summary</u>
As stated in the project description portion of this evaluation, the estimated capital expenditure for this project is $1,792,656, of which 75% is related to constructions costs; 16% is related to permits and fees; 6% is related to state sales tax; and the remaining 3% is related to equipment (both fixed and moveable). [source: Application, p20]

EGI will fund the project from reserves of Park Manor Rehabilitation Center. To demonstrate that the funding is available, EGI provided it most recent audited financial reports for years 2001, 2002, and 2003[8], and a letter of commitment from representative of EGI. [source: Application, Exhibits I and J]

After reviewing the applicant's December 31, 2003, audited financial report, the department concludes that the proposed financing is the most prudent approach, and the capital expenditure of this project would not negatively affect EGI's total assets, total liability, or

[7] The building lid calculation is an estimate based on information from a CN application. The calculation of the lid does not guarantee the inclusion of any costs considered in the calculation within the Medicaid rate [per DSHS].
[8] Year 2004 and 2005 reports were not available for this evaluation.

general financial health. Within its initial evaluation, the department concluded that EGI's application was consistent with this sub-criterion.

Reconsideration Evaluation
Under this reconsideration process, no additional information was provided that would change this conclusion by the department. This sub-criterion remains met.

B. Cost Containment (WAC 246-310-240)
Based on the source information reviewed, the department determines that the applicant has met the cost containment criteria in WAC 246-310-240.

(1) *Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.*
Initial Evaluation Summary
Within its initial evaluation, the department acknowledged EGI's consideration of other alternatives before submitting this project. [source: Application, 33] Further, in the need section of the initial evaluation, the department concurred with EGI's position regarding need for additional beds in the county. However, in the financial feasibility section of the initial evaluation, the department concluded that the applicant's long-term capital and operating costs of this project may not be met with the reduced Medicaid reimbursement calculated by ORM. Therefore, in the initial evaluation, the department concluded that approval of this project could jeopardize the viability of Park Manor Rehabilitation Center, and this sub-criterion was not met.

Reconsideration Evaluation
As previously stated, this project was denied for its failure to meet the CN review criteria of financial feasibility (WAC 246-310-220) and cost containment (WAC 246-310-240). The failure of the cost containment criterion was related to the project's failure under the financial feasibility criterion. Need for the project (WAC 246-310-210) and the applicant's and facility's demonstration of structure and process of care (WAC 246-310-230) were both determined to be demonstrated by the applicant.

Under this reconsideration, EGI provided documentation to demonstrate compliance with the financial feasibility criterion. Given the reconsideration financial feasibility conclusion, the department would also conclude that this project is the best alternative for the community, and this sub-criterion is met.

(2) *In the case of a project involving construction:*
(a) *The costs, scope, and methods of construction and energy conservation are reasonable;*
As stated in the project description portion of this evaluation, this project involves construction. This sub-criterion is evaluated within the financial feasibility criterion under WAC 246-310-220(2). Within the initial evaluation, the department determined the sub-criterion was met. Under this reconsideration process, no additional information was provided that would change this conclusion by the department. This sub-criterion remains met.

(b) *The project will not have an unreasonable impact on the costs and charges to the public of providing health services by other persons.*

This sub-criterion is also evaluated within the financial feasibility criterion under WAC 246-310-220(2). Within the initial evaluation, the department determined the sub-criterion was met. Under this reconsideration process, no additional information was provided that would change this conclusion by the department. This sub-criterion remains met.

Based on the above evaluation, the department concludes that costs, scope, and methods of construction and energy conservation are reasonable. This sub criterion remains met.